THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA
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March 17, 2005

Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut
Ontario Securities Commission
Prince Edward Island Securities Office
Autorité des marchés financiers
Saskatchewan Financial Services Commission
Registrar of Securities, Government of Yukon

c/o Blaine Young
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-and-

c/o Anne-Marie Beaudoin
Directrice du secrétariat
Authorité des marchés financiers
Tour de la Bourse
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Montréal, Québec H4Z 1G3

Dear Sirs/ Mesdames:

Re: IFIC's Comments on Proposed National Instrument 45-106 *Prospectus and Registration Exemptions*

We are writing to you on behalf of the Investment Funds Institute of Canada ("IFIC") and its Members to provide our comments on Proposed National Instrument 45-106 *Prospectus and Registration Exemptions* ("NI 45-106").

IFIC is the national association of the Canadian investment funds industry. IFIC's membership includes fund managers representing nearly 100% of the $517.6 billion in mutual fund assets under management in Canada[1], retail distributors of investment funds and affiliates from the legal, accounting and other professions.

We appreciate this opportunity to comment on NI 45-106. While we are supportive of the Canadian Securities Administrators' ("CSA") initiative to create a harmonized exemption regime in Canada, we do have several concerns with proposed NI 45-106, which are outlined below.

GENERAL COMMENTARY

Lack of harmonization

We commend the CSA for attempting to create a harmonized approach to registration and prospectus exemptions, and recognize that proposed NI 45-106 is a significant improvement over the exemption current regime. However, the proposal perpetuates many disparities and inconsistencies in the available exemptions. These disparities and inconsistencies result in the continued balkanization of current exemptions. We are strongly of the view that the exemptions should be harmonized among all Canadian jurisdictions.

We believe that the CSA should be satisfied with nothing less than a truly uniform exemptions rule, and not with an Instrument such as NI 45-106 that contains a patchwork of carve outs and exceptions. The Canadian investment industry, although relatively small, is quite competitive. In most cases, issuers, dealers and advisers who offer financial products cannot afford to restrict their operations to a single provincial or territorial jurisdiction. Accordingly, they must access the exempt market in multiple Canadian jurisdictions. Therefore, carve-outs and exceptions should only be permitted if a compelling case is made by a particular regulator for a different regime in their jurisdiction, based on the characteristics of the market and of investors in that jurisdiction.

If NI 45-106 is adopted as proposed, those who seek to raise capital in the exempt market will still be required to navigate different rules and implement different procedures in order to access the exempt market across Canada. We submit that these discrepancies, and the consequent inefficiencies, are not in the best interests of investors for at least two reasons. First, the costs of fragmentation are ultimately passed onto Canadian investors. Second, if issuers and distributors have to navigate different regimes to access the

[1] As at February 28, 2005 – source IFIC Member Statistics.

Canadian market, reluctance on the part of issuers to distribute their products in all Canadian jurisdictions may be created. Consequently, Canadian investors, in some jurisdictions, may be denied access to investment opportunities available in other jurisdictions. If a uniform capital raising regime existed in Canada, all investments would be more readily available across all Canadian jurisdictions. Therefore, we submit that creating an entirely uniform approach to registration and prospectus exemptions is in the best interests of the Canadian financial marketplace and Canadian investors.

Ontario only exemption rule

We commend the Ontario Securities Commission ("OSC") for its willingness to work with the other members of the CSA on establishing a uniform exemptions regime for Canada. However, we do not understand why the OSC has found it necessary to maintain its own exemption rule in OSC Rule 45-501 *Prospectus Exempt Distributions* ("OSC Rule 45-501"). We believe that the propensity for local carve-outs and exceptions must be overcome, and that all jurisdictions in Canada must work together to achieve the goal of a harmonized approach to exemptions.

OSC Rule 45-501, by its very existence, is inconsistent with the goal of a National Instrument. Exemptions affect market conditions in all Canadian jurisdictions in the same way. In our view, local carve outs, such as the Ontario only exemption rule, create enormous compliance duplications, are cost inefficient and maintain the current fragmented regime.

SPECIFIC COMMENTARY

Section 1.1 *Definitions*, definition of "accredited investor"

Ontario exemption- We commend the OSC for removing the current restriction that prohibits fully managed accounts from investing in securities of investment funds in reliance on the accredited investor exemption, and for harmonizing the exemption with the other CSA jurisdictions.

However, we do have concerns that relate to the proposal that except in Ontario, a person acting on behalf of a fully managed account who is registered or authorized to carry on business as an adviser under securities legislation of a foreign jurisdiction will be an accredited investor. In our view, the OSC's position that it "has not concluded that the registration requirements in all foreign jurisdictions are appropriate for the Ontario market"[2] is unreasonable.

Ontario currently has a registration regime that requires an adviser in Ontario who advises persons resident in Ontario to register as a fully registered adviser or as an international adviser permitted to advise a restricted class of clients. The carve-out in NI

[2] National and Ontario Prospectus and Registration Exemptions, (2004) 27 OSCB (Supp-3), at page 5.

45-106 appears to affect advisers who are acting for clients outside of Ontario with respect to purchases from Ontario-based issuers. If this is the case, we question why the OSC is concerned about the registration requirements in foreign jurisdictions of advisers who advise residents of those foreign jurisdictions. If the foreign jurisdiction determines that its requirements are sufficient for its residents, the OSC should come to the same determination.

Perhaps the OSC is concerned that advisers registered as international advisers will be able to utilize the exemption. In this case, the OSC has already determined that it is appropriate for international advisers to advise individuals on their limited list of permitted clients. Therefore, we question why these permitted clients are prohibited from taking advantage of the exemption available to advisers in respect of their fully-managed accounts.

We also seek clarification on why the OSC deems it appropriate to reject the accredited investor exemption in respect of foreign advisers who advise their foreign clients (both those outside of Canada and those in other Canadian jurisdictions), and why international advisers are also prohibited from taking advantage of the benefit of the exemption. We do not see whom the OSC is protecting by precluding foreign advisers from the category of accredited investors in Ontario when dealing with their fully managed accounts. At a minimum, we submit that advisers registered in foreign jurisdictions having registration rules similar to those in effect in Ontario should be considered to be accredited investors in Ontario.

Clause (n)- The words "in the jurisdiction" should be added after "an investment fund that distributes or has distributed its securities only to persons". No policy rationale is provided for precluding a pooled fund, which has distributed its securities in a foreign jurisdiction in compliance with the requirements of that jurisdiction, from being considered to be an accredited investor in Canada, even though all of the investors from the foreign jurisdiction may not qualify as accredited investors in Canada.

Subclause (n)(ii)- This subclause permits an investment fund that distributes, or has distributed, its securities to persons in the circumstances referred to in sections 2.10 *minimum amount investment* and 2.19 *additional investment in investment funds* to be considered to be an accredited investor. We believe that an investment fund that distributes, or has distributed, its securities to persons in the circumstances referred to in section 2.18 *investment fund reinvestment* should also be considered to be an accredited investor and added to those listed in subclause (n)(ii). There should not be a distinction made between the distribution circumstances in sections 2.10 and 2.19 and the distribution circumstances in section 2.18.

Section 1.1 *Definitions*, definition of "eligibility adviser"

We believe that the term "eligibility adviser" is an inappropriate term to describe the concept of an individual who advises eligible investors. The use of the term "eligibility

adviser" may lead to confusion, and misunderstanding since the "adviser" is not providing advice on the eligibility of investments, but rather is advising on the suitability of investments for eligible investors. We suggest that the term "eligibility consultant" is appropriate and better describes an individual who advises eligible investors.

We also question why accountants and lawyers are considered to be appropriate "eligibility advisers" in Saskatchewan and Manitoba, but not in the other Canadian jurisdictions, and what the policy reason is for this different treatment of accountants and lawyers.

Section 1.1 *Definitions*, definition of "non-redeemable investment fund"

Since reference to the term "non-redeemable investment fund" is made in several Instruments, we believe that a single definition of this term should be added to National Instrument 14-101 *Definitions* so that all references to "non-redeemable investment fund" could be harmonized in all Instruments.

Sections 2.5 *Family, friends and business associates* and 2.6 *Family, founder and control person-Ontario*

Ontario exception- We disagree with the OSC's assumption that the family, friends and business associates exemption allows exempt securities to be distributed to an "unlimited group". In fact, the exemption is limited to the group of individuals and entities that are clearly identified in section 2.5 of NI 45-106. Ontario issuers and investors should have the flexibility to rely on this exemption just as other Canadian issuers and investors can rely on it. Although we do not support differences between the jurisdictions, if Ontario is unwilling to provide for the exemption on an unqualified basis, we suggest that it could provide for a risk acknowledgment in certain circumstances, as is being proposed in Saskatchewan.

Definition of "founder"- We believe that the founder of an issuer should not be required to be "actively involved in the business of the issuer" in order to benefit from the family, friends and business associates exemption. If an individual takes the initiative in founding, organizing or substantially reorganizing the business of an issuer, this individual should be considered to have an appropriate level of in-depth knowledge about the issuer so as to warrant an exemption from the protection of the Instrument.

Subsections 2.6(2) *Family, friends and business associates* and 2.9(14) *Offering memorandum*

We believe that the requirement in subsections 2.6(2) and 2.9(14) of NI 45-106 for issuers and sellers to maintain signed risk acknowledgements for a period of eight years after a distribution or trade is unnecessarily burdensome. Given the cost of maintaining and filing these documents, we suggest that a shorter than eight year time period would be appropriate.

Section 2.9 *Offering memorandum*

The offering memorandum exemption is a significant benefit to certain corporate issuers. However, while it is possible for investment funds to utilize the offering memorandum exemption, investment funds rarely take advantage of the exemption. This is, in part, due to the fact that not all of the offering memorandum's required disclosure applies to all investments funds, such as working capital deficiency, short term objectives and how the issuer intends to achieve these objectives. Mutual funds are more diversified than other securities and as such, most mutual fund investors are exposed to lower risk than many pure corporate investors. We, therefore, believe that a specific offering memorandum exemption for investment funds is appropriate and should be designed.

In addition, we question why the OSC has prohibited the offering memorandum exemption from applying in Ontario, and seek clarification on why investors in Ontario are being treated differently than investors in the other Canadian jurisdictions.

As a housekeeping matter, we note that the text of the exemption does not mention Yukon, and, therefore, issuers and dealers in Yukon are advised on if and when they are able to rely on the offering memorandum exemption.

Subsection 2.10(1)(b) *Minimum amount investment*

We suggest that this provision should be amended to permit the required $150,000 to be paid *in specie*. We believe that if an investor has paid $150,000 *in specie*, and as long as the required amount is fully paid, it is appropriate for this investor to benefit from the minimum amount investment exemption. If there is a concern about the valuation of an *in specie* payment, delivery and settlement conditions similar to those found in section 9.4 of National Instrument 81-102 *Mutual Funds* could be included in NI 45-106.

Sections 2.18 *Investment fund reinvestment*

An investment fund reinvestment plan can either be (i) an optional plan that it is selected by the investor; or (ii) an automatic plan that is an inherent feature of a fund as disclosed in the fund's prospectus. We believe that the exemption in subsection 2.18(1) of NI 45-106 should be broadened as it appears that the exemption, as proposed, only covers the situation in which a reinvestment plan is an optional plan as selected by an investor.

Subsection 2.18(5) of NI 45-106 proposes that disclosure be required only in a fund's prospectus. However, in the interest of providing investors with more appropriate disclosure, we believe that the Instrument should take into account the option of including the required disclosure in a fund's financial statements since an investor is only required to receive a fund's prospectus when the fund is purchased, but will generally receive the financial statements each time they are filed.

Sections 2.18 *Investment fund reinvestment* and 2.19 *Additional investment in investment funds*

The proposed investment fund reinvestment and additional investment in investment funds exemptions are too restrictive and do not take into account multi-class and multi-series funds. We believe that an investor should be able to take advantage of these exemptions if the units being purchased are those of a fund that has the same portfolio assets as those attributed to the securities currently held by the investor.

We do not see a policy basis for requiring that the additional investment or reinvestment of distributions be in the same class/series, provided that the securities are tied to the same underlying portfolio. The investment fund reinvestment and additional investment in investment funds exemptions should be linked to investment in a fund with the same portfolio assets and not to a particular series or class of the fund. This linkage would provide flexibility to investors, without permitting them to reinvest or make additional investments in another investment portfolio of the same fund, for example a fund with multiple classes each representing a different portfolio of investments. It would also permit investors to switch between classes/series without being required to satisfy the minimum investment amount at the time of the switch and permit investors to direct reinvestments of distributions into a different series/class of the same fund.

Section 2.44 *Removal of exemptions- market intermediaries*

We question the connection between subsection 2.44(1) of NI 45-106 and section 3.2 of Companion Policy 45-106CP. Subsection 2.44(1) lists the exemptions that are unavailable in Ontario to market intermediaries. However, section 3.2 of Companion Policy 45-106CP states that the exemptions listed in subsection 2.44(1) are unavailable to market intermediaries in Newfoundland and Labrador, as well as Ontario.

Since both Ontario and Newfoundland and Labrador have universal registration regimes, we request clarification on whether market intermediaries in Newfoundland and Labrador are subject to the exemptions listed in subsection 2.44(1) in the same way that market intermediaries in Ontario are subject to these exemptions.

Related registration issues

Limited market dealers- Since the stated goal of proposed NI 45-106 is to harmonize the registration exemptions in Canada, we question why Ontario and Newfoundland and Labrador are maintaining the "Limited Market Dealer" registration category. This registration category maintains a universal registration regime only in these two jurisdictions, which preserves the current fragmented registration and exemption regime in Canada. We believe that it is appropriate for Ontario and Newfoundland and Labrador to revisit whether universal registration is appropriate.

The sale of pooled funds and other exempt products- The current regime, where mutual fund dealers in some jurisdictions can sell pooled funds (including hedge funds) and other exempt products, GICs and other financial instruments while they cannot sell such products in other jurisdictions, is unreasonable. It is vital that the CSA recognize that consistency across Canada on this issue is important. Many mutual fund dealer firms conduct their business in many, if not all, Canadian jurisdictions. It is imperative that a uniform Canadian standard be established regarding what mutual fund dealers can and cannot sell. We understand that the CSA is currently developing a registration Instrument, and we strongly urge that these issues be addressed by the CSA.

Capital accumulation plan exemption

We believe that the Capital Accumulation Plan (CAP) exemption in CSA Notice 81-405 *Proposed Exemptions for Certain Capital Accumulation Plans* should be integrated into NI 45-106. It would be extremely efficient to consolidate all exemptions into a single harmonized National Instrument.

Note that while we are generally supportive of the CAP proposal and its intended harmonization of the treatment of mutual funds as investments within CAPs, we are of the view that certain aspects of the exemption do not appear to take into account some practical situations, which can occur with respect to CAP members. In addition, we have some concerns about the degree to which the proposal meets the harmonization goal stated by the CSA.

For a thorough explanation of our comments on the proposed CAP exemption, including our comments on the form of the exemption, the harmonized treatment of mutual funds and segregated funds in the exemption, how CAPs deal with former employees and their spouses and the exemption's filing requirements, please consult IFIC's *CSA Notice 81-405 Proposed Exemptions for Certain Capital Accumulation Plans* submission to the CSA dated July 30, 2004.

CLOSING REMARKS

We would like to reiterate our support for the goal of achieving a harmonized exemptions rule in Canada. However, as noted, we believe that proposed NI 45-106 does not achieve this goal. Perpetuating a system where the securities regulatory authority in a jurisdiction can formulate exceptions or carve-outs when its does not agree with the other CSA members, absent demonstrable unique circumstances in their particular province or territory, does not result in harmonization and consolidation.

We strongly believe that all jurisdictions in Canada must work together to achieve the significant goal of harmonization. This means that all jurisdictions must be prepared to make some compromises so that genuine harmonization and uniformity can be achieved.

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We look forward to the opportunity to discuss these matters with you. Please contact the undersigned directly by email at jmurray@ific.ca or by telephone at (416) 363-2150 Ext. 225; or Stacey Shein, Legal Counsel, by email at sshein@ific.ca or by telephone at (416)363-2150 x238, should you require further information or wish to discuss our comments.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: "Original signed by John W. Murray"

John W. Murray
Vice President, Regulation & Corporate Affairs